2018

The Fundamentals of GAAP: Case Studies of Accounting Principles

Lindsey N. Dunn
University of Mississippi. Sally McDonnell Barksdale Honors College

The Fundamentals of GAAP: Case Studies of Accounting Principles

By

Lindsey Nicole Dunn

A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements for the Sally McDonnell Barksdale Honors College.

Oxford

May 2018

Approved by

Advisor: Dr. Victoria Dickinson

Reader: Dr. W. Mark Wilder

ACKNOWLEDGEMENTS

I would like to thank everyone who has championed the success of my collegiate career including my parents, family, friends, professors, and Phi Mu sisters; thank you for believing in me and celebrating every victory, small or large, with me over the past four years. Thank you Patterson School of Accountancy and all the faculty and staff for supporting all my scholastic endeavors, and for continuing to uphold the integrity and excellence of the accountancy program. Most importantly, thank you to my God for giving me the ability to learn and the resources to pursue my dreams.

ABSTRACT

The following paper consists of solutions to case studies that provide an overview of accounting principles in accordance with the Generally Accepted Accounting Principle set forth by the Financial Standards Accounting Board. Each case addresses a different area of financial reporting within a specific company, and demonstrates comprehension and practice of accounting concepts, financial analysis, and preparation of financial statements. These cases were completed under the direction of Dr. Victoria Dickenson in fulfillment of the requirements for the University of Mississippi ACCY 420 honors course in the 2016-2017 academic year.

Table of Contents

Case 1: Home Heaters

Financial Analysis and Comparison of Glenwood Heating, Inc. and Eads Heating, Inc.

Prepared by Lindsey Dunn

September 7, 2016

Table of Contents

I. Executive Summary

Provided below are comparable financial statements for Glenwood Heating, Inc. and Eads Heating, Inc., companies selling home heating units. Both companies began operations at the beginning of year 20X1 under like economic conditions with each manager making different accounting choices. An analysis of the financial statements will show that although Glenwood is more profitable during their first year of operation, Eads is a better long-term investment.

II. Glenwood Heating, Inc. Financial Statements

a. Glenwood Income Statement

Glenwood Heating, Inc. Income Statement For the Year Ended Dec. 31, 20X1		
Sales		
Sales Revenue		$ 398,500
Cost of Goods Sold		177,000
Gross Profit		221,500
Operating Expenses		
Bad Debt Expense	$ 994	
Depreciation Expense	19,000	
Rent Expense	16,000	
Other Operating Expenses	34,200	70,194
Income from operations		151,306
Other Expenses and Losses		
Interest Expense		27,650
Income before Income Tax		123,656
Income Tax		30,914
Net Income from Continuing Operations		**$ 92,742**
Earnings per Share		**$ 28.98**

b. Glenwood Trial Balance

Glenwood Heating, Inc. Trial Balance For the Year Ended Dec. 31, 20X1		
Account	**Dr**	**Cr**
Cash	$ 426	
Accounts Receivable	99,400	
Allowance for Bad Debt		$ 994
Inventory	62,800	
Land	70,000	
Building	350,000	
Equipment	80,000	
Accum. Dep, Building		10,000
Accum. Dep, Equipment		9,000
Leased Equipment		
Accum. Dep, Leased Equip		
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		
Common Stock		160,000
Retained Earnings		
Dividends	23,200	
Sales		398,500
COGS	177,000	
Bad Debt Expense	994	
Depreciation Expense	19,000	
Interest Expense	27,650	
Other Operating Expenses	34,200	
Rent Expense	16,000	
Provision for Income Tax	30,914	
Total	**$ 991,584**	**$ 991,584**

c. Glenwood Statement of Changes in Stockholders' Equity

Glenwood Heating, Inc. Statement of Changes in Stockholders' Equity For the Year Ended Dec. 31, 20X1			
	Common Stock	**Retained Earnings**	**Total**
Balance on Jan 1	$ 160,000		$ 160,000
Net income		$ 92,742	92,742
Dividends		(23,200)	(23,200)
Balance on Dec 31	$ 160,000	$ 69,542	$ 229,542

d. Glenwood Classified Balance Sheet

Glenwood Heating, Inc. Classified Balance Sheet For the Year Ended Dec. 31, 20X1		
Current Assets		
Cash	$ 426	
Accounts Receivable	99,400	
Less: Allowance for Bad Debt	(994)	
Inventory	62,800	
Total Current Assets		$ 161,632
Fixed Assets		
Land	70,000	
Building	350,000	
Equipment	80,000	
Less: Accumulated Depreciation, Building	(10,000)	
Less: Accumulated Depreciation, Equipment	(9,000)	
Total Fixed Assets		481,000
Total Assets		**$ 642,632**
Current Liabilities		
Accounts Payable	26,440	
Note Payable	5,000	
Interest Payable	6,650	

Total Current Liabilities		38,090
Long-term Liabilities		
Note Payable	375,000	
Total Long-term Liabilities		375,000
Equity		
Common Stock	160,000	
Retained Earnings	69,542	
Total Equity		229,542
Total Liability and Equity		**$ 642,632**

e. Glenwood Statement of Cash Flows

Glenwood Heating, Inc. Statement of Cash Flow For the Year Ended Dec. 31, 20X1		
Cash Flow from Operating Activity		
Net Income		$ 92,742
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation Expense	$ 19,000	
Bad Debt Expense	994	
Increase in Inventory	(62,800)	
Increase in Accounts Receivable	(99,400)	
Increase in Accounts Payable	26,440	
Increase in Interest Payable	6,650	
Net Cash Flow from Operating Activity		(16,374)
Cash Flow from Investing Activity		
Purchase of Land	(70,000)	
Purchase of Building	(350,000)	
Purchase of Equipment	(80,000)	
Net Cash Flow from Investing Activity		(500,000)
Cash Flow from Financing Activities		
Proceeds from Common Stock	160,000	
Payment of Cash Dividends	(23,200)	
Proceeds from Note Payable	380,000	
Net Cash Flow from Financing Activity		516,800
Total Net Cash Flow		**$ 426**

III. Eads Heating, Inc. Financial Statements

a. Eads Income Statement

Eads Heating, Inc. Income Statement For the Year Ended Dec. 31, 20X1				
Sales				
Sales Revenue			$	398,500
Cost of Goods Sold				188,800
Gross Profit				209,700
Operating Expenses				
Bad Debt Expense	$	4,970		
Depreciation Expense		41,500		
Other Operating Expenses		34,200		80,670
Income from operations				129,030
Other Expenses and Losses				
Interest Expense				35,010
Income before Income Tax				94,020
Income Tax				23,505
Net Income from Continuing Operations			**$**	**70,515**
Earnings per Share			**$**	**22.04**

b. Eads Trial Balance

Eads Heating, Inc. Trial Balance For the Year Ended Dec. 31, 20X1				
Account		**Dr**		**Cr**
Cash	$	7,835		
Accounts Receivable		99,400		
Allowance for Bad Debt			$	4,970
Inventory		51,000		
Land		70,000		
Building		350,000		
Equipment		80,000		

Accum. Dep, Building		10,000
Accum. Dep, Equipment		20,000
Leased Equipment	92,000	
Accum. Dep, Leased Equip		11,500
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		83,360
Common Stock		160,000
Retained Earnings		
Dividends	23,200	
Sales		398,500
COGS	188,800	
Bad Debt Expense	4,970	
Depreciation Expense	41,500	
Interest Expense	35,010	
Other Operating Expenses	34,200	
Rent Expense		
Provision for Income Tax	23,505	
Total	**$ 1,101,420**	**$ 1,101,420**

c. Eads Statement of Changes in Stockholders' Equity

Eads Heating, Inc.
Statement of Changes in Stockholders' Equity
For the Year Ended Dec. 31, 20X1

	Common Stock	Retained Earnings	Total
Balance on Jan 1	$ 160,000		$ 160,000
Net income		$ 70,515	70,515
Dividends		(23,200)	(23,200)
Balance on Dec 31	$ 160,000	$ 47,315	$ 207,315

d. Eads Classified Balance Sheet

Eads Heating, Inc. Classified Balance Sheet For the Year Ended Dec. 31, 20X1		
Current Assets		
Cash	$ 7,835	
Accounts Receivable	99,400	
Less: Allowance for Bad Debt	(4,970)	
Inventory	51,000	
Total Current Assets		$ 153,265
Fixed Assets		
Land	70,000	
Building	350,000	
Equipment	80,000	
Leased Equipment	92,000	
Less: Accumulated Depreciation, Building	(10,000)	
Less: Accumulated Depreciation, Equipment	(20,000)	
Less: Accumulated Depreciation, Leased Equipment	(11,500)	
Total Fixed Assets		550,500
Total Assets		**$ 703,765**
		-
Current Liabilities		
Accounts Payable	26,440	
Lease Payable	9,330	
Interest Payable	6,650	
Total Current Liabilities		42,420
Long-term Liabilities		
Note Payable	380,000	
Lease Payable	74,030	
Total Long-term Liabilities		454,030
Equity		
Common Stock	160,000	
Retained Earnings	47,315	
Total Equity		207,315
Total Liability and Equity		**$ 703,765**

e. Eads Statement of Cash Flows

Eads Heating, Inc. Statement of Cash Flow For the Year Ended Dec. 31, 20X1		
Cash Flow from Operating Activity		
Net Income		$ 70,515
Adjustments to reconcile net income to net cash provided by operation activities:		
Depreciation Expense	$ 41,500	
Bad Debt Expense	4,970	
Increase in Inventory	(51,000)	
Increase in Accounts Receivable	(99,400)	
Increase in Accounts Payable	26,440	
Increase in Interest Payable	6,650	
Net Cash Flow from Operating Activity		(325)
Cash Flow from Investing Activity		
Purchase of Land	(70,000)	
Purchase of Building	(350,000)	
Purchase of Equipment	(80,000)	
Net Cash Flow from Investing Activity		(500,000)
Cash Flow from Financing Activities		
Proceeds from Common Stock	160,000	
Payment of Cash Dividends	(23,200)	
Proceeds from Note Payable	380,000	
Payment on Leased Equipment	(8,640)	
Net Cash Flow from Financing Activities		508,160
Total Net Cash Flow		**$ 7,835**

IV. Financial Analysis and Recommendation

Although Glenwood appears to be more profitable at first glance, Eads is a better candidate for investment. Eads uses double-declining depreciation rate on delivery equipment as opposed to Glenwood using straight-line depreciation rate, making their depreciation expense more than twice as much as Glenwood's depreciation expense. This accounts largely for the difference in the net income of the two companies. Eads' decision to use the double-declining depreciation method more accurately records the value of the delivery equipment since the value of any vehicle decreases greatly the moment it is put to use. Furthermore, Glenwood is going to carry a greater depreciation expense than Eads in years to come.

Another component that ensures Eads to be more profitable long-term is the leased equipment agreement. Both companies obtain equipment for $16,000; however, Glenwood's agreement is only a rental agreement of $16,000 for the next year and Eads' is a capital agreement ensuring $16,000 per year for the next eight years of operation creating a more stable and reliable expense. Additionally, at the end of the lease agreement Eads will have an asset to show for its cash outlay whereas Glenwood will not.

Eads is also more conservative in their assumption of bad debt. They prepare for 5% of accounts receivable being uncollected whereas Glenwood only assumes 1% will be uncollectable.

Finally, Eads generates significantly more cash flow on less taxable income than Glenwood. The preceding accounting choice's made by Eads Heating, Inc. make them the superior investment option.

Appendix A: Transactions for Glenwood Heating, Inc.

Parenthesis' indicate a Credit

Glenwood Heating, Inc.

Transactions

For the Year Ended Dec. 31, 20X1

Transaction	Cash	Accounts Receivable	Allowance for Bad Debt	Inventory	Land	Building	Accum Dep-Building	Equipment	Accum Dep-Equipment	Leased Equipment	Accum Dep-Leased Equipment
No. 1	$ 160,000										
No. 2	400,000										
No. 3	(420,000)				70,000	350,000					
No. 4	(80,000)							80,000			
No. 5				239,800							
No. 6		398,500									
No. 7	299,100	(299,100)									
No. 8	(213,360)										
No. 9	(41,000)										
No. 10	(34,200)										
No. 11	(23,200)										
No. 12											
No. 13			(994)								
No. 14				(177,000)							
No. 15							(10,000)		(9,000)		
No. 16	(16,000)										
No. 17	(30,914)										
Total:	**$ 426**	**$ 99,400**	**$ (994)**	**$ 62,800**	**$ 70,000**	**$ 350,000**	**$(10,000)**	**$ 80,000**	**$(9,000)**	**$ -**	**$ -**

Glenwood Heating, Inc.

Transactions

For the Year Ended Dec. 31, 20X1

Transaction	Accounts Payable	Interest Payable	Note Payable	Lease Payable	Common Stock	Retained Earnings	Dividends	Sales
No. 1					$ (160,000)			
No. 2			(400,000)					
No. 3								
No. 4								
No. 5	(239,800)							
No. 6								(398,500)
No. 7								
No. 8	213,360							
No. 9		-	20,000					
No. 10								
No. 11							23,200	
No. 12		(6,650)						
No. 13								
No. 14								
No. 15								
No. 16								
No. 17								
Total:	**$(26,440)**	**$ (6,650)**	**$(380,000)**	**$ -**	**$(160,000)**	**$ -**	**$ 23,200**	**$(398,500)**

Glenwood Heating, Inc.
Transactions
For the Year Ended Dec. 31, 20X1

Transaction	Costs of Goods Sold	Bad Debt Expense	Depreciation Expense	Interest Expense	Other Operating expense	Rent Expense	Provision for income tax
No. 1							
No. 2							
No. 3							
No. 4							
No. 5							
No. 6							
No. 7							
No. 8							
No. 9				$ 21,000			
No. 10					34,200		
No. 11							
No. 12				6,650			
No. 13		994					
No. 14	177,000						
No. 15			19,000				
No. 16						16,000	
No. 17							30,914
Total:	**$ 177,000**	**$ 994**	**$ 19,000**	**$ 27,650**	**$ 34,200**	**$ 16,000**	**$ 30,914**

Appendix B: Eads Heating, Inc. Transactions

Eads Heating Inc.

Transactions
For Year Ended Dec. 31, 20X1

Transaction	Cash	Accounts Receivable	Allowance for Bad Debt	Inventory	Land	Building	Accum Dep-Building	Equipment	Accum Dep-Equipment
No. 1	$160,000								
No. 2	400,000								
No. 3	(420,000)				70,000	350,000			
No. 4	(80,000)							80,000	
No. 5				239,800					
No. 6		398,500							
No. 7	299,100	(299,100)							
No. 8	(213,360)								
No. 9	(41,000)								
No. 10	(34,200)								
No. 11	(23,200)								
No. 12									
No. 13			(4,970)						
No. 14				(188,800)					
No. 15							(10,000)		(20,000)
No. 16	(16,000)								
No. 17	(23,505)								
Total:	**$ 7,835**	**$ 99,400**	**$ (4,970)**	**$ 51,000**	**$ 70,000**	**$ 350,000**	**$ (10,000)**	**$ 80,000**	**$ (20,000)**

Eads Heating Inc. **Transactions** **For Year Ended Dec. 31, 20X1**									
Transaction	Leased Equipment	Accum Dep-Leased Equipment	Accounts Payable	Interest Payable	Note Payable	Lease Payable	Common Stock	Retained Earnings	Dividends
No. 1							$ (160,000)		
No. 2					(400,000)				
No. 3									
No. 4									
No. 5			(239,800)						
No. 6									
No. 7									
No. 8			213,360						
No. 9				-	20,000				
No. 10									
No. 11									23,200
No. 12				(6,650)					
No. 13									
No. 14									
No. 15									
No. 16	92,000	(11,500)				(83,360)			
No. 17									
Total:	**$ 92,000**	**$ (11,500)**	**$ (26,440)**	**$ (6,650)**	**$ (380,000)**	**$ (83,360)**	**$ (160,000)**	**$ -**	**$ 23,200**

Eads Heating Inc.

Transactions
For Year Ended Dec. 31, 20X1

Transaction	Sales	Costs of Goods Sold	Bad Debt Expense	Depreciation Expense	Interest Expense	Other Operating expense	Rent Expense	Provision for income tax
No. 1								
No. 2								
No. 3								
No. 4								
No. 5								
No. 6	$ (398,500)							
No. 7								
No. 8								
No. 9					21,000			
No. 10						34,200		
No. 11								
No. 12					6,650			
No. 13			4,970					
No. 14		188,800						
No. 15				30,000				
No. 16				11,500	7,360			
No. 17								23,505
Total:	**$ (398,500)**	**$ 188,800**	**$ 4,970**	**$ 41,500**	**$ 35,010**	**$ 34,200**	**$ -**	**$ 23,505**

Case 2: Totz and Doodlez

Income Statement Presentation Analysis

Prepared by Lindsey Dunn

September 21, 2016

Table of Contents

I. Executive Summary

Totz is a high-end children's clothing retail store that has been in operation for the years 2014, 2015, and 2016. Totz fiscal year is 52 weeks long and ends on the Saturday closest to January 31st. In addition to clothing, Totz brought in Doodlez, an in-store art studio, in the third quarter of 2015. Doodlez is service based, providing painting, pottery, and drawing classes. Provided below is an analysis of how additional financial information should be presented on the income statement.

II. Recommendation on Income Statement Presentation

a. Net Sales

Totz had an increase in net sales from $74.5 in fiscal 2015 to $86.5 million in fiscal 2016. This $12 million increase is composed of a $7.4 million increase in service revenue derived from Doodlez and a $4.7 million increase in retail sales due to customers favoring more natural fibers used in Totz clothing. According to ASC 225-10-S99-2:

> (b) If income is derived from more than one of the sub-captions described under § 210.5–03.1, each class which is not more than 10 percent of the sum of the items may be combined with another class. If these items are combined, related costs and expenses as described under § 210.5–03.2 shall be combined in the same manner.
>
> 1. Net sales and gross revenues. State separately:
>
> (a) Net sales of tangible products (gross sales less discounts, returns and allowances),
>
> (b) operating revenues of public utilities or others;
>
> (c) income from rentals;

(d) revenues from services; and

(e) other revenues.

Net sales from Totz and service revenue from Doodlez both exceed the 10 percent threshold; they should be reported separately in the sales section of operating income as “Net sales of tangible products” and “revenues from services”, respectively.

b. Gross Profit

Fiscal 2015 had a gross profit of $28 million that increased to $30.4 million in fiscal 2016. Gross profit equals net sales less cost of sales. Cost of sales includes product costs, freight in and import costs, and direct labor costs for Doodlez employees, but excludes depreciation expenses. According to ASC-225-10-S99-8:

> If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below)."

Exclusion of depreciation expenses from cost of sales must be noted within the cost of sales line item. Depreciation expenses must still be stated as a cost or expense within the operating section of the income statement according to ASC-225-10-S99-2-b-3. Failure to report depreciation expenses will result in overstating gross profit and therefore net income of Totz.

Furthermore, cost of sales increased $9.6 million from $46.5 million in fiscal 2015 to $56.1 million in fiscal 2016; this increase is largely due to cost of Doodlez services. According to ASC 225-10-S99-2-b-2:

> 2. Costs and expenses applicable to sales and revenues. State separately the amount of
>
> (a) cost of tangible goods sold,
>
> (b) operating expenses of public utilities or others,
>
> (c) expenses applicable to rental income,
>
> (d) cost of services, and
>
> (e) expenses applicable to other revenues.

Authoritative guidance states in ASC 225-10-S99-2-b that the 10 percent threshold also applies to costs and expenses. Cost of sales generated from Totz and Doodlez each exceed 10 percent of total cost of sales and should be reported separately as “cost of tangible goods” and “cost of services”, respectively, within the cost of sales segment in the operating section of the income statement.

c. Gain on Sale of Corporate Headquarters

During fiscal 2016, Totz relocated to Mountain View, CA and sold its corporate headquarters building for a gain of $1.7 million dollars. According to ASC-225-20-50-3, “The nature and financial effects of each event or transaction that is unusual in nature or occurs infrequently, but not both, shall be disclosed on the face of the income statement or, alternatively, in notes to the financial statements.” ASC-225-20-55-2 states, “an event or transaction of a type not reasonably expected to recur in the foreseeable future is considered to occur infrequently.” Since the nature of a corporate headquarter is a stable, centralized location, the relocation of Totz's corporate headquarters is considered infrequent as another relocation is not "reasonable expected to recur in the foreseeable future". Therefore, the gain on the sale of the previous corporate headquarters building should be reported separately as non-operating income within the continued operations section of the income statement.

d. Class Action Settlement

Totz realized that the natural fiber materials provided by one of their fabric suppliers was not actually natural. In fiscal 2016, Totz received $2.7 million settlement from a class action lawsuit they filed against the supplier. According to ASC-225-20-50-3, "The nature and financial effects of each event or transaction that is unusual in nature or occurs infrequently, but not both, shall be disclosed on the face of the income statement or, alternatively, in notes to the financial statements." According to the glossary of the authoritative guidance, an event of unusual nature, "should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates," and an infrequent event, "should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates." The class action settlement is unusual and infrequent due to the settlement being unrelated to the ordinary activities of Totz and not reasonably expected to happen again. Therefore, the proceeds received from the settlement should be reported separately as non-operating income in the continued operations section of the income statement.

It should be noted that the outcome of this class action settlement being that the fiber material was not natural could affect the net sales for fiscal 2016. ASU 225-10-S99-2 states that net sales of tangible products should be reported net of sales discounts, returns, and allowances. Since the primary increase in retail sales was due to favorable customer responses to clothing being made from more natural fiber, it is highly probable that sales returns will increase.

Case 3: Rocky Mountain Chocolate Factory, Inc.

Financial Statement Preparation

Prepared by Lindsey Dunn

October 5, 2016

Table of Contents

I. Introduction

Provided below are journal entries of several major economic events occurring for Rocky Mountain Chocolate Factory, Inc. Rocky Mountain is an international franchisee, confectionery manufacturer and retail operator whose revenues are derived from three principal sources: chocolate and other confectionery products to franchises and other retail stores, franchise fees and royalties, and company-owned store sales. Simple financial statements have been prepared from the provided information.

II. Journal Entries

General Ledger			
JE	**Account**	**Dr.**	**Cr.**
1	Raw Material	7,500,000	
	Accounts Payable		7,500,000
2	Inventory	6,000,000	
	Wages Payable		6,000,000
3	Cash	17,000,000	
	Accounts Receivable	5,000,000	
	Sales		22,000,000
	Cost of Goods Sold	14,000,000	
	Inventory		14,000,000
4	Acounts Payable	8,200,000	
	Cash		8,200,000
5	Cash	4,100,000	
	Accounts Receivable		4,100,000
6	Sales and Marketing Expense	1,505,431	
	General and Admin Expense	2,044,569	
	Retail Operating Expense	1,750,000	
	Cash		2,000,000
	Other Accrued Expenses		3,300,000
7	Wages Payable	6,423,789	
	Cash		6,423,789
8	Cash	125,000	
	Deferred Income		125,000
9	Property and Equipment	498,832	
	Cash		498,832

10	Retained Earnings	2,407,167	
	Cash		2,403,458
	Dividend Payable		3,709
12	Cost of Sales	216,836	
	Inventory		216,836
13	Depreciation and amortization	698,580	
	Property and equipment		698,580
14	General and Administrative	639,200	
	Retail operating	6,956	
	Accrued salaries and wages		646,156
15	No JE		

Closing Entries		
Income Summary	24,883,681	
Cost of Sales		14,910,622
Franchise Costs		1,499,477
Sales and Marketing		1,505,431
General and Administrative		2,422,147
Retail Operation		1,756,956
Depreciation and amortization		698,580
Income tax expense		2,090,468
Sales	22,944,017	
Interest Income	27,210	
Franchise and Royalty Fees	5,492,531	
Income Summary		28,463,758
Income Summary	3,580,077	
Retained Earnings		3,580,077

III. Trial Balance

Account	Beginning Balance	Unadjusted Trial Balance	Pre-closing Balance	Post-closing balance
Cash and cash equivalents	1,253,947	3,743,092	3,743,092	3,743,092
Accounts receivable	4,229,733	4,427,526	4,427,526	4,427,526
Notes receivable, current	-	91,059	91,059	91,059
Inventories	4,064,611	3,498,283	3,281,447	3,281,447
Deferred income taxes	369,197	461,249	461,249	461,249
Other	224,378	220,163	220,163	220,163
Property and Equipment, net	5,253,598	5,885,289	5,186,709	5,186,709
Notes receivable, less current portion	124,452	263,650	263,650	263,650
Goodwill, net	1,046,944	1,046,944	1,046,944	1,046,944
Intangible assets, net	183,135	110,025	110,025	110,025
Other	91,057	88,050	88,050	88,050
Accounts payable	1,074,643	877,832	877,832	877,832
Accrued salaries and wages	423,789	-	646,156	646,156
Other accrued expenses	531,941	946,528	946,528	946,528
Dividend payable	598,986	602,694	602,694	602,694
Deferred income	142,000	220,938	220,938	220,938
Deferred income taxes	827,700	894,429	894,429	894,429
Common stock	179,696	180,808	180,808	180,808
Additional paid-in capital	7,311,280	7,626,602	7,626,602	7,626,602
Retained earnings	5,751,017	3,343,850	3,343,850	6,923,927
Sales	-	22,944,017	22,944,017	-

Franchise and royalty fees	-	5,492,531	5,492,531	-
Cost of sales	-	14,693,786	14,910,622	-
Franchise costs	-	1,499,477	1,499,477	-
Sales and marketing	-	1,505,431	1,505,431	-
General and Administrative	-	1,782,947	2,422,147	-
Retail operating	-	1,750,000	1,756,956	-
Depreciation and amortization	-	-	698,580	-
Interest income	-	- 27,210	- 27,210	-
Income tax expense	-	2,090,468	2,090,468	-

IV. Statement of Retained Earnings

Rocky Mountain Chocolate Factory Statement of Retained Earnings For the Year Ended February 28, 2010		
Retained Earnings, February 2009	$	5,751,017
Add: Net Income		3,580,077
Less: Dividends		(2,407,167)
Retained Earnings, February 2010	$	6,923,927

V. Income Statement

Rocky Mountain Chocolate Factory Income Statement For the Year Ended February 28, 2010		
Revenue		
Sales	$ 22,944,017	
Franchise and Royalty Fees	5,492,531	
Total Revenues		$ 28,436,548
Costs and Expenses		
Cost of Sales (excluding Depreciation and Amortization)	14,910,622	
Franchise Costs	1,499,477	
Sales and Marketing	1,505,431	
General and Administrative	2,422,147	
Retail Operation	1,756,956	
Depreciation and Amortization	698,580	
Total Costs and Expenses		22,793,213
Operating Income		**5,643,335**
Other Income and Expenses		
Interest Income		27,210
Income Before Income Taxes		5,670,545
Income Tax Expense		2,090,468
Net Income		**$ 3,580,077**
Basic Earnings per Common Share		$ 0.60
Diluted Earnings per Common Share		$ 0.58
Weighted Average Common Shares Outstanding		6,012,717
Dilutive Effect of Employee Stock Options		197,521
Weighted Average Common Shares Outstanding, Assuming Dilution		6,210,238

VI. Balance Sheet

Rocky Mountain Chocolate Factory Balance Sheet For the Year Ended February 28, 2010		
Assets		
Current Assets		
Cash and Cash Equivalents	$ 3,743,092	
Accounts Receivable, Less Allow. for Doubtful Accounts	4,427,526	
Notes Receivable, Current	91,059	
Inventories	3,281,447	
Deferred Income Taxes	461,249	
Other	220,163	
Total Current Assets		$ 12,224,536
Property and Equipment, Net		5,186,709
Other Assets		
Notes Receivable, Less Current Portion	263,650	
Goodwill, Net	1,046,944	
Intangible Assets, Net	110,025	
Other	88,050	
Total Other Assets		1,508,669
Total Assets		**$ 18,919,914**
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	877,832	
Accrued Salaries and Wages	646,156	
Other Accrued Expenses	946,528	
Dividend Payable	602,694	
Deferred Income	220,938	
Total Current Liabilities		3,294,148
Deferred Income Taxes		894,429
Stockholders' Equity		
Common Stock	180,808	
Additional Paid-In Capital	7,626,602	
Retained Earnings	6,923,927	
Total Stockholders' Equity		14,731,337
Total Liabilities and Stockholders' Equity		**$ 18,919,914**

VII. Cash Flow Classifications

Transaction Classification in Statement of Cash Flows		
	Transactions	**Classification**
1	Purchase Inventory	Operating
2	Incur Factory Wages	Operating
3	Sell Inventory for Cash and On Account	Operating
4	Pay for Inventory	Operating
5	Collect Receivables	Operating
6	Incur SG&A (cash and payable)	Operating
7	Pay Wages	Operating
8	Receive Franchise Fee	Operating
9	Purchase PPE	Investing
10	Dividends Declared and Paid	Financing
11	All Other Transactions	NONE
12	Adjust for Inventory Count	Operating
13	Record Depreciation	Operating
14	Wage Accrual	Operating
15	Consultant's Report	NONE

Case 4: Small Business Fraud Schemes

Analysis of Potential Fraud and Internal Control Solution

Prepared by Lindsey Dunn

October 18, 2016

I. Introduction

The following table presents a series of possible fraud schemes that could have occurred at a small craft store located in Oxford, Mississippi. The scheme is accompanied by possible internal control solutions to remedy the problem or prevent it from happening.

II. Fraud Scheme and Solution

Fraud Scheme	Internal Control
Lack of a time clock enables employees to lie about the time they have worked.	Technology Update: An online program/software should be implemented to record and time hours worked (suggestion: Paycom.com).
An employee accepts a check for merchandise and completely bypasses the electronic system.	Physical Audit: A physical count of inventory should be done periodically to make sure sales and ending inventory match total inventory.
Since there is not a physical inventory count and all employees have authority to enter all types of transactions, an employee can make a sale and then create a false return right after and pocket the cash from the sale.	Separation of Duties: There should be only one employee authorized to make returns during the shift. Approval Authority: All employees are able to make returns but must first have approval from a manager to create this transaction. Physical Audits: A physical count of inventory and cash should be taken. Cash should be done on a daily basis; depending on size of the store, inventory counts can be done less frequently—monthly or quarterly.
Discount added to full price for customer to pay, system shows entire price recorded, employee pockets difference between full price and full price plus discount	Physical Audit: There should be a physical count of cash at the end of an employee's shift. Cash sales and credit sales should equal the amount of cash and total for credit card transactions, respectively.

Lack of security measures make it easy for employees to steal merchandise.	<u>Physical safeguards:</u> Cameras, locks, and sensors can be used to ensure that all merchandise taken outside of the store is paid for. Additionally, it adds to the safety of employees and merchandise in the case of a robbery.
The business is running on a simple accounting software.	<u>Technology update:</u> Using a more advanced accounting system can more accurately pinpoint and track discrepancies. In light of expansion, a more advanced system in necessary.
Lucy handles minor customer complaints. She could fake a complaint asking for a refund and then pocket the money for the refund.	<u>Separation of Duties:</u> There should be more than one person handling complaints and customer service. A suggested pipeline is delegating complaints and customer service to an experienced employee. This employee will forward the issue along with a solution to the manager who either approves or declines the suggestion. Upon approval, the store owner will send an email to the customer inquiring if the customer service was handled correctly and satisfying.
Employees can disguise fraud by using another employees access code to the register	<u>Access Controls:</u> Each employee's code to the register should be changed periodically to ensure they are kept unique and secret. <u>Separation of Duties:</u> Authorize only two employees to create transactions during the shift, and designate them to a specific register. This places the responsibility of each register reconciling on one employee.
Lucy has access to the accounting system and thus the inventory system; she can alter the inventory to cover up discrepancies in sales and the electronic inventory count.	<u>Access Controls:</u> Passwords should be implemented to access different parts of the accounting system. Not only does it keep unauthorized users out of the system but makes it easier to identify the source of error or discrepancy.

Employees are authorized to enter all types of transactions.	Approval Authority: Transactions of a large dollar amount or transactions that require a large amount of cash change being given back to the customer should be required to have manager approval before occurring.
Lucy summarizes and records daily sales in the accounting system and prepares bank deposits.	Separation of Duties: The job of reporting and depositing should be separated to lessen the chance of fraud.

Case 5: Inventory

Overview of Inventory

Prepared by Lindsey Dunn

November 2, 2016

Table of Contents

I. Inventory Costs

The costs associated with raw materials inventory include the cost of all component parts of the product and the freight cost of getting the raw materials to the manufacturing site. The types of costs included in works in process inventory are the raw material being used, and the proportion of direct labor and overhead that has incurred thus far. Finished goods inventory cost is composed of the raw material, direct labor, and overhead cost that apply to the final product.

II. Inventory, Net

The inventory balances are recorded net of an allowance estimated for obsolete or unmarketable inventory. This estimated allowance is based on historical experiences, sales trends, current inventory levels, market conditions, and forecasts of future product demand.

III. Allowance for Obsolete or Unmarketable Inventory

a. The allowance for obsolete or unmarketable inventory does not directly appear on the company's financial statements; it is accounted for by inventory being recorded net of the allowance for obsolete or unmarketable inventory account. If the company chose for the account to appear on the financial statements, it should appear on the balance sheet as a deduction below the "Inventory" account.

b. The gross amount of inventory is $243,870 and $224,234 for the years 2011 and 2012, respectively.

c. The portion of the obsolete inventory account attributed to the different inventory accounts is 20.53% for raw materials, .29% for works in process, and 79.18% for finished goods in 2012. In 2011, it is 20.16% for raw materials, .55% for works in process, and 79.29% for finished goods.

IV. Journal Entries for Allowance

Account	Dr.	Cr.
Cost of Goods Sold	13,348	
Allowance for Obsolete or Unmarketable Inventory		13,348
Allowance for Obsolete or Unmarketable Inventory	11,628	
Finished Goods		11,628

V. T-Accounts

Raw Materials

Dr.	Cr.
46,976	442,068
438,561	
43,469	

Accounts Payable

Dr.	Cr.
432,197	39,012
	438,561
	45,376

Works in Process

Dr.	Cr.
1,286	568,735
126,000	
442,068	
619	

Finished Goods

Dr.	Cr.
184,808	13,348
568,735	572,549
167,646	

Cost of Goods Sold

Dr.	Cr.
572,549	
13,348	
585,897	

a. The cost of finished goods sold for the current year is $585,897.

b. The cost of finished goods transferred from work in process for the current year is $568,735.

c. The cost of raw materials transferred to work in process for the current year is $442,068.

d. The cost of raw materials purchased in the current year is $438,561.

e. The amount of cash disbursed for raw materials purchases during the current year is $432,197.

VI. Inventory Turnover Ratio

For the year 2011, the company's inventory turnover ratio was 2.3 times; for the year 2012, they increased their turnover ratio to 2.6 times.

VII. Inventory Holding Period

In 2011, it took the company an average of 158.7 days to manufacture and sell its inventory. An increase in inventory management efficiency in 2012, reduced the inventory holding period to 140.4 days.

VIII. Estimated Percentage of Obsolete or Unmarketable Inventory

The total allowance for obsolete or unmarketable goods is $24,148; the company estimated that 13.07% of finished goods would be obsolete or unmarketable. Additionally, I would like to know why the estimate for obsolete goods is so high seeing that the allowance accounts ending balance is over $10,000 for 2011 and 2012. The estimation being too high is overstating cost of sales and therefore overstating the loss from operations.

Case 6: WorldCom, Inc.

Capitalized Costs and Earnings Quality

Prepared by Lindsey Dunn

November 16, 2016

I. Concepts

a. FASB Statement of Concepts No. 6

i. The FASB Statement of Concepts No. 6 defines an asset as a resource of economic value controlled by an individual or company that is expected to provide future benefit. Assets add to the value of the company whether it be generating future cash flows, improving sales, or reducing expenses. Expenses are defined as the economic cost of the operations of a business to produce revenue; according to the principles of accounting, all expenses must match a revenue. A few common expenses are payment for supplies, leases for equipment or buildings, and employee wages and salaries.

ii. Generally, a cost is capitalized if it is adding to the value of the asset or if the acquired resource provides a benefit for more than one operating cycle. If the cost is only maintaining the condition or repairing the asset, then the cost is expensed.

b. After a cost is capitalized, it is depreciated over its useful life. This principle of capitalizing certain costs and then depreciating them is so the expense of the cost matched the revenue that it generates. This is represented by a depreciation expense on the income statement and a contra asset of accumulated depreciation on the balance sheet.

II. Process

c. WorldCom reported $14,739 billion in line costs for the year of 2013. This expense category includes the charges paid to local telephone networks to complete calls.

Journal Entry:

Account	Dr.	Cr.
Line Cost (expense)	14,739,000,000	
Cash		14,739,000,000

d. The line costs that were improperly recorded at WorldCom are access charges and transport charges paid to local telephone networks.

e. The capitalization of the costs to property, plant, and equipment appears on the current asset section of the balance sheet. The expense is found on the statement of cash flows under investing activities as "capital expenditures".

Journal Entry:

Account	Dr.	Cr.
PP&E (asset)	3,055,000,000	
Line Cost (expense)		3,055,000,000

III. Analysis

f. Calculation of Depreciation Expense

Quarter	Capitalized Amount	Life (years)	Portion of Year	Depreciation Expense
1	771,000,000	22	1	$ 35,045,455
2	610,000,000	22	0.75	20,795,455
3	743,000,000	22	0.5	16,886,364
4	931,000,000	22	0.25	10,579,545
Total Depreciation Expense for 2001:				**$ 83,306,818**

Journal Entry:

Account	Dr.	Cr.
Depreciation Expense	83,306,818	
Accumulated Depreciation		83,306,818

g. WorldCom previously reported net income to be $1,501,000,000 that included the capitalization of a portion of the line costs incurred throughout the year. With proper adjustments, the net income that WorldCom should have reported for 2001 is a net loss of $341,150,568 making the difference between what was reported by WorldCom and the actual bottom line, in fact, material.

Adjustments	
Income before taxes, as reported	$ 2,393,000,000
Depreciation on costs improperly capitalized	83,306,818
Less: Improperly capitalized line costs	(3,055,000,000)
Loss before taxes, restated	(578,693,182)
Income tax benefit	202,542,614
Minority interest	35,000,000
Net loss, restated	$ (341,150,568)

Case 7: Targa Co.

Analysis of Restructuring Costs

Prepared by Lindsey Dunn

February 8, 2017

Table of Contents

I. Summary

Targa Co. is a manufacturing company that is restructuring one of its business lines. Included in the restructuring plan is the discontinuation of the research and development facility of Targa's Armor Track line, displacing 120 to 125 of the 140 employees currently at the location. Targa will use this location for expansion of another line and relocate the manufacturing operations to a different geographical location. Management has created a one-time non-voluntary termination plan for its employees that is estimated to cost $2.5 million with an additional $500,000 for the historical practice of providing two weeks' severance for employees involuntarily terminated for non-performance-related reasons. In order to receive the one-time benefits, employees must continue service through the date the facility closes. Additionally, the facility manager of the affected location will receive $50,000 in accordance to their employment agreement.

Furthermore, Targa will incur costs for relocation and staff training, which are expected to be $500,000 and $1.5 million respectively. The Company is also involved in irrevocable contracts with relevant parties that will affect the restructuring plan over the course of the next 18 months.

II. Employee Termination Benefits

The benefit plan laid out for terminated Targa employees is divided into two segments—the two weeks' severance and the one-time termination benefit. Employees that do not wish to fulfill employment through the closing of the facility are only entitled to the two weeks' severance benefits whereas employees that render service through the closing of the facility are entitled to both the severance benefits and the one-time termination benefits.

Targa will account for these benefits separately. The two weeks' severance is classified as a nonretirement postemployment benefit according to ASC 712-10-15 and should be recorded as a liability and a loss as stated in ASC 712-10-25-2:

> An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments.

Additionally, this standard applies to the employment agreement of $50,000 due to the facility manager.

The one-time termination benefits offered to employees that remain active through closing meet all criteria for classification as "one-time employee termination benefits" as stated in ASC 420-10-25-4:

> An arrangement for one-time employee termination benefits exists at the date the plan of termination meets all of the following criteria and has been communicated to employees (referred to as the communication date):
>
> a. Management, having the authority to approve the action, commits to a plan of termination.
>
> b. The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.

c. The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.

d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

The classification of one-time employee termination benefits in conjunction with the receipt of these benefits being contingent on continued services affects the way that Targa will account for the liability. In accordance to ASC 420-10-25-9 that states:

> if employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, a liability for the termination benefits shall be measured initially at the communication date based on the fair value of the liability as of the termination date, and shall be recognized ratably over the future service period.

Targa will record the fair value of the one-time termination benefits, which is $2.5 million, on the communication date, which is December 27, 20X1.

III. Retraining and Relocation Costs

In addition to the cost of employee termination benefits, Targa will incur relocation and staff training costs. The restructuring plan is considered an exit activity according to ASC 420-10-15-4, which states:

> An exit activity includes but is not limited to a restructuring, such as the sale or termination of a line of business, the closure of business activities in a particular location, the relocation of business activities from one location to another, changes in management structure, and a fundamental reorganization that affects the nature and focus of operations.

The costs incurred through the relocation of the business line and training new employees are considered exit activity costs. These costs should be recorded as a liability in the period that it is incurred according to ASC 420-10-25-1 that states, "A liability for a cost associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred."

IV. Analysis

For the year ended December 31, 20X1, Targa will report a $500,000 liability and loss due to the historical two weeks' severance, a $50,000 liability and loss due to the facility manager's employment agreement, and a $2.5 million liability for the one-time termination benefits. Expenses such as the relocation and retraining costs will be reported when incurred.

Case 8: Merck & Co., Inc.

Shareholders' Equity

Prepared by Lindsey Dunn

February 15, 2017

Table of Contents

I. Merck's Common Shares

a. Merck is authorized to issue 5.4 billion shares.

b. Merck has issued 2,983.5 million shares for the year ended December 31, 2007.

c. Merck has issued 2,983.5 million shares with a par value of one cent. This gives the issued shares a dollar value of $29.8 million as presented on the balance sheet.

d. Merck has issued 811 million shares of treasury stock for the year 2007.

e. Merck has 2,171.5 million shares outstanding.

f. Market capitalization of Merck for December 31, 2007 is $125.2 billion.

II. Dividends

Companies declare dividends on common shares when they have reached an optimal point of retained earnings. Rather than accumulating a large amount of retained earnings, companies pay dividends to investors. However, when companies pay dividends to shareholders, the share price typically decreases.

III. Share Buyback

When a company does a share buyback and purchases their own shares on the open market, they are lowering the number of shares outstanding and therefore increasing the remaining shareholders' interest in the company. When share buybacks are done in good faith, it is in the best interest of the shareholders. However, a company can buy back shares to appear more financially fit and improve financial ratios; this would not benefit the remaining shareholders.

IV. 2007 Dividend Activity Journal Entry

Account	Dr.	Cr.
Retained Earnings	33,105,000,000	
Dividends Payable		3,400,000
Cash		3,307,300,000

V. Treasury Stock

a. Merck uses the cost method to record treasury stock. This method records the shares at the cost in which they bought back the shares, not the par value or price investors originally paid at issuance.

b. Merck repurchased 26.5 million treasury shares in 2007.

c. On average, Merck spent in total $1,429.7 million on treasury stock and $53.95 per share in 2007. The repurchase of the treasury stock is represented on the cash flow statement on the finance section as a cash outflow.

d. Although treasury stock could be considered a future economic benefit if it is sold at a higher value than the company repurchased it (creating a gain), treasury stock cannot be considered an asset because companies cannot generate income with their own stock.

VI. Ratio Analysis

Merck & Co., Inc. Ratio Analysis (stated in millions)	2007	2008
Dividends Paid	$ 3,307	$ 3,323
Shares Outstanding	2,172.5	2,167.8
Net Income	3,275.4	4,433.8
Total Assets	48,350.7	44,569.8
Operation Cash Flows	6,999.2	6,765.2
Year-end Stock Price	$ 57.61	$ 41.94
Dividends per Share	$ 1.52	$ 1.53
Dividend Yield	2.64%	3.65%
Dividend Payout	100.82%	74.81%
Dividends to Total Assets	6.84%	7.45%
Dividends to Operating Cash Flows	47.25%	49.11%

Case 9: Xilinx, Inc.

Stock-Based Compensation

Prepared by Lindsey Dunn

March 1, 2017

Table of Contents

I. Stock Option Plans

A stock option is a plan that gives the buyer a right to own stock in a company at a fixed price. Companies can issue stock options to employees as a form of compensation, allowing them to have stake in the company. An option does not have to be exercised but in most cases an employee will exercise the option at a time when the market price is higher than the exercise price. Stock options usually have a time limit in which an employee can exercise their option. In this case, Xilinx offers stock options as a means to retain current employees and attract new talent. The goal is to create a sense of ownership within the employee making them want to invest their service to the firm indefinitely.

II. Restricted Stock Units

Like stock options, restricted stock units are compensation based incentives used to retain employees. Restricted stock units differ from stock options in that after the vesting period the employee is given the stock or cash equivalent rather than having to pay the exercise price. However, restricted stock units typically only grant a third to a fifth of the amount of stock that a stock option would contain. It would be advantageous for a company to offer both stock options and RSUs because they provide different benefits to the company and the employee. A stock option gives more stock to the employee and allows the company to receive a fixed amount for those stock whereas RSUs could be considered free since the employee is not paying an exercise price but they do not receive as much stock. Additionally, while there is less risk on the return of RSUs since the employee has not financially invested into the stock, the return is also limited by the number of stock in the unit. Conversely, a stock option has a higher chance of a greater return since it contains a larger amount of stock but is riskier due to the uncertainty of the market price.

III. Stock Option Terms

The date that the stock option or RSU is declared is referred to as the "grant date" and is the day that the "vesting period" begins. During the vesting period, the company amortizes the expense of the program offered. Once the vesting period is over, the employee may exercise the option at the "exercise price", which is the fixed price set at the time the option is granted. On the "expiration date" the contract for the option or RSU becomes null and the employee can no longer receive the benefit.

Stock options can take three different statuses: granted, exercised, and forfeited; RSUs can only take two statuses: granted and forfeited. Options or RSU's granted are the number of stock options or RSUs that the company has granted to employees but are either still in the vesting period or, for an option, has not been exercised. Once a stock option has been exercised, it will then move to the category "options exercised". Stock options and RSUs that are not exercised before the expiration date or do not fulfill contract terms, respectively, are considered "options/RSUs forfeited".

IV. Employee Stock Purchase Plan

An employee stock purchase plan allows employees to purchase company shares at a discounted price. At the offering date, which is similar to the grant date for a stock option, deductions from the employees participating in the ESPP will be made from their payroll. Xilinx limits participation to 15% of the employee's annual income up to $21 thousand in a calendar year. At the offering date, the employee obtains a 24-month purchase right that allows them to purchase stock at the end of every six months, if they choose, with the accumulated deductions. Employees receive a 15% discount on the lower of the fair market value at the beginning of the 24-month offering period or at the end of the six-month exercise period.

Because stock options and RSUs have to be granted, employee stock purchase plans provide an opportunity for a larger portion of the company to have ownership at a discounted price. The sense of ownership and the shorter vesting period are two incentives for employees to invest in the ESPP. Additionally, deductions for weekly payroll are easier to manage than having to pay a full exercise price for a stock option when the employee wishes to exercise their option.

V. Stock-based Compensation

The Company must record all employee equity awards at the grant date fair value and amortize that cost as a compensation expense over the vesting period. Any unvested portion of shares that have already been granted but remain outstanding must be recorded as compensation expense. Cash flows received from tax benefits of share-based payments will be classified as part of cash flows from operation activities. All tax benefits in excess of the deferred tax asset attributable to compensation costs for stock options will be classified as cash flows from financing activities. The exercise price for stock options will be the closing market price on the grant date. Xilinx's employee stock purchase plan is a compensatory plan and will be factored into computation of stock-based compensation expense. The company will recognize the compensation expense using the straight-line method over the service period of the equity award.

VI. Stock-based Compensation Expense in Financial Statements

a. The total expense that Xilinx reported for stock-based compensation in 2013 is $77,862.

b. The stock-based compensation expense will be found in three different places on the income statement: cost of revenues, research and development expense, and selling, general and administrative expense. The expense is split into the line item that most appropriately fits the labor of the employee receiving the stock-based compensation.

c. The stock-based compensation expense increases cash flows for operating activities. Since the expense is split by the employee's labor category on the income statement and compensation is contingent on continued service, it is appropriate to include the compensation expense as an operating activity.

d. The stock-based compensation expense allows the company to defer a larger tax asset for the year rather than incur the entire tax expense at one time.

e. Journal Entry:

Account	Dr.	Cr.
Cost of Revenues	6,356	
Research and Development	37,937	
Selling, General and Administrative	33,569	
Additional PIC-Stock based Compensation		77,862
Deferred Tax Asset	22,137	
Income Tax Payable		22,137

VII. "Last Gasp for Stock Options"

a. In recent years' companies have started to abandon stock options due to shareholder demand, tax-law changes and the 2008 financial crisis, and move towards issuing more restricted stock awards. In 1999 stock options made up 78% of an executive's incentive package whereas in 2013, options represented only 31% of the package. Restricted stock awards have become more attractive to management due to the risk associated with stock options. Since a stock option is issued at an exercise price for a future date, it is uncertain whether the market price of the shares will exceed the predetermined exercise price, making the stock options worthless. Additionally, companies are drawn to issue restricted stock awards rather than stock options because there are less regulations and policy that effect restricted stock awards; any regulations or policies that do affect them tend to be more uniform from country, state, and city whereas stock option regulation frequently vary from place to place. Because there is more certainty in restricted stock awards, employees would prefer being granted restricted stock units rather than a stock option. The potential for a stock option to become worthless or even fall below the exercise price could be detrimental for employee morale and the company.

b. The yearly progression of Xilinx stock options and restricted stock units follow to trend outlined in the article. In 2010 the number of options outstanding was 31,026, and decreased to 24,969 in 2011 and 17,788 is 2012. In 2013, options outstanding totaled to 12,753. The trend is also supported by an increase in restricted stock units outstanding. In 2010, RSUs totaled to 3,652 and have increase every year to 4,215 in 2011 and 5,239 in 2012. In 2013, RSUs outstanding totaled to 5,996.

Case 10: Bier Haus

Revenue Recognition

Prepared by Lindsey Dunn

March 8, 2017

Table of Contents

I. Summary

The following case is presented in four parts with each part giving a different scenario of a student buying beer. Each part varies in how and when the revenue from the respective transaction is recognized. The scenarios are given and followed by a step break-down of the five-step revenue model and the journal entries that correlate with the transaction.

II. Part 1

"A college student walks into the Bier Haus on campus and orders a large plastic cup of beer. The bartender takes the order and says it will cost $5. The student hands the bartender $5. The bartender then pours the beer into a large cup and hands it to the student. The student rushes off to ACCY 304."

a. Five-Step Revenue Model

Step 1: The student and bartender form an oral contract when the student walks in and the bartender takes their order. The contract establishes that the student will receive a large cup of beer in exchange for $5.

Step 2: The performance obligation in the contract is the bartender fulfilling the order for the student.

Step 3: The transaction price is $5, which is exchanged for the cup of beer.

Step 4: The entire $5 transaction price is allocated to the performance obligation of the bartender pouring the beer.

Step 5: Bier Haus would recognize the revenue from this transaction once the bartender hands the student the beer since this is when the performance obligation is satisfied.

b. Journal Entry

Account	Dr.	Cr.
Cash	5	
Sales Revenue		5

III. Part 2

"The same student goes into the Bier Haus and orders a large beer in an Ole Miss thermal beer mug as part of a "drink on campus" campaign. The student plans to use this mug daily for refills rather than using plastic cups. The bartender pours the beer into the mug and delivers it to the student. The bartender then collects $7 from the student. Standalone selling prices are $5 for the beer and $3 for the mug, so the student got a bargain on the combined purchase. The student takes the beer in the new mug and enjoys it while reading the codification."

a. Five-Step Revenue Model

Step 1: The student and bartender create an oral contract when the student goes into Bier Haus and orders a large beer in an Ole Miss thermal beer mug in exchange for $7.

Step 2: Since the beer and mug are distinct goods that can benefit the student separately, they are each considered a performance obligation in the contract.

Step 3: The transaction price for the beer and mug is $7.

Step 4: The transaction price allocated to the two performance obligations of beer and the mug are $4.38 and $2.62, respectively.

Step 5: The revenue from this transaction is recognized when the bartender completes each performance obligation. Since the bartender hands the mug and the beer to the student, the full $7 is recognized at that time.

b. Journal Entry

Account	Dr.	Cr.
Cash	7	
Sales Revenue		7

IV. Part 3

"The same student goes into the Bier Haus bringing in his beer mug and orders a large beer and a pretzel. Standalone selling prices are $5 for the beer and $2 for the pretzel. The bartender tells the student they are out of pretzels. The bartender then offers the student the large beer and a coupon for two pretzels (its typical business practice) for $7. The student pays the $7 to the bartender. The bartender gives the student a coupon for two pretzels. The bartender pours the beer into the beer mug and hands it to the student. The student then takes the beer and the coupon and heads to the dorm to study for the upcoming Intermediate accounting exam. The Bier Haus sells a coupon for two pretzels for $3.50. To increase visits, these coupons can be redeemed any date after the date of purchase. The Bier Haus has limited experience with these coupons but, so far, these coupons have always been redeemed."

a. Five-Step Revenue Model

Step 1: The student walks in and creates an oral contract with the bartender which states for $7 the student will receive a large beer and a coupon for two pretzels.

Step 2: Within the contract, there are two performance obligations: fulfilling the order for the large beer and the future performance obligation of fulfilling the coupon for two pretzels.

Step 3: The transaction price for the large beer and pretzel coupon is $7.

Step 4: The transaction price allocated to the beer and the coupon are $4.12 and $2.88, respectively.

Step 5: At this time Bier Haus would only recognize revenue of $4.12 since the bartender only satisfied the performance obligation of the large beer. The remaining $2.88 will be accounted for as unearned revenue until the coupon is redeemed and the performance obligation is satisfied.

b. Journal Entry

Account	Dr.	Cr.
Cash	7	
Sales Revenue		4.12
Unearned Revenue		2.88

V. Part 4

"The same student goes into the Bier Haus and orders two pretzels. The bartender takes the order and asks for a $4 payment. The student hands the bartender the coupon. The bartender reviews the coupon, determines its validity, and accepts it as payment. The bartender gives the student the two pretzels. The student then heads off to share the pretzels with a classmate from ACCY 420."

a. Five-Step Revenue Model

Step 1: The student and bartender are creating an oral contract that exchanges two pretzels for a coupon the student previously received.

Step 2: The performance obligation that must be fulfilled is the pretzels being given to the student. This obligation is from a previous transaction when the coupon was issued to the student.

Step 3: The transaction price for this situation is the coupon which has an allocated cost of $2.88 from the previous transaction.

Step 4: The allocated cost is $2.88 which is derived from the transaction in part 3 when the student purchases the large beer and the coupon.

Step 5: The revenue allocated to the coupon in part 3 will now be recognized since the student received two pretzels and the performance obligation has been satisfied.

b. Journal Entry

Account	Dr.	Cr.
Unearned Revenue	2.88	
Sales Revenue		2.88

Case 11: ZAGG, Inc.

Deferred Income Taxes

Prepared by Lindsey Dunn

March 21, 2017

Table of Contents

I. Book Income vs Taxable Income

The term "book income", also known as pretax financial income, refers to the income amount derived from financial accounting. In 2012, ZAGG, Inc reported book income as $23,898 on the statement of operations. A company's book income is based on financial accounting whereas tax income is based on tax accounting, which is similar to cash-based accounting. Taxable income includes revenue that has been received but not earned and expenses are not deducted until they are paid. Additionally, tax accounting prohibits some forms of revenues and expenses from being included in taxable income. Revenue recognition, accrued liabilities, and restrictions on certain forms of revenues and expenses create a difference between book income and taxable income.

II. Definitions

a. Permanent Tax Difference

Per the 16th edition of the Wiley *Intermediate Accounting* textbook, **permanent tax difference** "results from items that (1) enter into pretax financial income but never into taxable income, or (2) enter into taxable income but never into pretax financial income." Permanent tax differences only occur in the tax year in which it occurs but is permanent because it will not be reversed in years to come. An example is if a company pays a $50K political expense, their book income is going to be $50k shorter than their taxable income because lobbying and political expenses are not eligible to be deducted from taxable income.

b. Temporary Tax Difference

The 16th edition of the Wiley *Intermediate Accounting* textbook, **temporary tax difference** "is the difference between the tax basis of an asset or liability and its reported (carrying or book) amount in the financial statements, which will result in taxable amounts or deductible amounts in future years." Temporary differences arise often due to revenue recognition and accrued liabilities. Although a company may receive revenue, according to financial accounting they would not recognize it until they fulfill the performance obligation. However, in tax accounting income is recognized when it is received. This can create a temporary discrepancy between financial and taxable incomes but is often fixed over the course of a few years. Similarly, accrued liabilities cause the same problem. An expense must be recorded as soon as it is recognized in financial accounting, but tax accounting typically does not recognize the expense until it has been paid. For example, if a company is renting an office building from July 1, 2017 to June 30, 2018 for a lump sum of $10,000 paid on July 1, 2017, the deductible amount for taxable income in the year 2017 will be $10,000; however, the expense's reported amount would be $5,000 for 2017 and $5,000 for 2018. Therefore, the company's lower taxable income in 2017 is made up for a higher taxable income in 2018.

c. Statutory Tax Rate

The **statutory tax rate** is the tax rate established by the law of the taxing jurisdiction.

d. Effective Tax Rate

The **effective tax rate** is the average tax rate that companies are taxed on pre-tax profits.

III. Deferred Income Taxes

A deferred income tax expense arises from temporary tax differences occurring in the current year that will affect taxes payable in future years. Therefore, a company would report deferred income taxes as part of their total income tax expense to account for the difference in the financial statements.

IV. Deferred Tax Assets and Liabilities

A deferred income tax expense arises from temporary tax differences occurring in the current year that will affect taxes payable in future years. Therefore, a company would report deferred income taxes as part of their total income tax expense to account for the difference in the financial statements.

V. Deferred Income Tax Valuation Allowance

A deferred income tax valuation allowance is used in the case that a company suspects that there is slightly more than a fifty percent chance that it will not realize either the entire deferred tax asset or a portion of it. The valuation account is a contra account to the deferred tax asset account. At the time when the company determines it is more likely than not that they will not realize the entire tax asset, they would debit the income tax expense account and credit the valuation allowance account.

VI. ZAGG, Inc. – Income Taxes

a. Journal Entry for Income Tax Provision

Account	Dr.	Cr.
Income Tax Expense	9,393	
Net Deferred Tax Asset	8,293	
Income Tax Payable		17,686

b. Journal Entry for Deferred Tax Asset and Liability

Account	Dr.	Cr.
Income Tax Expense	9,393	
Deferred Tax Asset	8,002	
Deferred Tax Liability	291	
Income Tax Payable		17,686

c. Effective Tax Rate

ETR = Tax Expense/Pretax Income = 39.3%

d. Balance Sheet Presentation

The deferred income tax asset balance of $13,508 is found in two places on the balance sheet, current and noncurrent assets. The current portion of the deferred income tax assets is $6,912 and the noncurrent portion is $6,596, which totals to $13,508.

Case 12: Build-A-Bear Workshop, Inc.

Leases

Prepared by Lindsey Dunn

April 12, 2017

Table of Contents

I. Leased vs Purchased Assets

A company may choose to lease an asset rather than buy it for several reasons. While leasing an asset probably costs more actual cash flow, a lower upfront cost is typically more beneficial for a company. Additionally, there are tax benefits since lease payments on business equipment is a deductible business expense. Leased equipment can also be more easily replaced in the need for more up-to-date equipment.

II. Lease Definitions

a. Operating Lease

An operating lease is short in terms of the useful life of the asset and is used to acquire equipment on a short-term basis. Rather than recording the equipment as a leased asset and a liability it is reported as an expense.

b. Capital Lease

A capital lease entitles the renter to temporary use of an asset but treating it as an asset owned for accounting purposes. Rather than expensing the cost of the lease, the renter must add assets and liabilities that correspond to the lease of the asset. If a rental contract meets one of the following criteria it is considered a capital lease:

- If there a bargain purchase option at the end of the lease term
- If the title transfers at the end of the lease from the lessor to the lessee
- If the lease term is greater than or equal to the useful/economic life
- If the present value of the lease payments is greater than or equal to 90% the property's value

c. Direct-Financing Lease

A direct-financing lease is a type of capital lease where the lessor combines a sales and financing transaction. When the asset is transferred from the lessor to the lessee, the lessor removes the asset from the books and replaces it with a receivable. Interest income is the only income recognized by the lessor and is configured by using the IRR of the asset as the implied rate, cash inflow being the lease payments, and cash outflow being the book value of the lease asset.

d. Sales-Type Lease

A sales-type lease is similar to a direct-finance lease except that profit derived from the contract is recognized upon the inception of the lease in addition to interest income received over the lease term. The profit recognized is the present value of all lease payments less the cost of the leased asset.

III. Distinguishing Between Leases

Since leases can have a variety of characteristics they are categorized into two different types- operating and capital leases. The main difference between these two leases are how the leased asset is reported thus it is important for an accountant to distinguish what kind of lease they are working with.

IV. Hypothetical Lease Scenario

a. Under current US GAAP standards, the lease would be treated as an operating lease because the lease does not meet any of the following criteria to be considered a capital lease:

- If there a bargain purchase option at the end of the lease term

- If the title transfers at the end of the lease from the lessor to the lessee, then it is a capital lease
- If the lease term is greater than or equal to the useful/economic life
- If the present value of the lease payments is greater than or equal to 90% the property's value.

b. Journal Entry for Rent Expense

Account	Dr.	Cr.
Rent Expense	100,000	
Cash		100,000

c. Journal Entry for Year 1

Account	Dr.	Cr.
Rent Expense	100,000	
Cash		100,000

Journal Entry for Year 2-5

Account	Dr.	Cr.
Rent Expense	100,000	
Deferred Rent	25,000	
Cash		125,000

V. Build-A-Bear Workshop's Operating Lease Commitments

a. The rent expense for fiscal 2009 is $46.8 million.

b. The rent expense from the operating lease is lumped into the "Selling, general, and administrative" line item.

VI. Converting Operating Lease to Capital Lease

a.

Period	Lease Payment	Appropriate Discount Factor	PV of Payment
1	$ 50,651	0.9346	$ 47,337
2	47,107	0.8734	41,145
3	42,345	0.8163	34,566
4	25,469	0.7629	27,059
5	31,319	0.713	22,330
6	25,229	0.6663	16,811
7	25,229	0.6227	15,711
8	25,229	0.582	14,683
		Total:	**$ 219,642**

b. Journal Entry to Convert Lease

Account	Dr.	Cr.
Property and Equipment	219,643	
Lease Obligation		219,643

c. Journal Entry to Convert Lease

Account	Dr.	Cr.
Lease Obligation	35,276	
Interest Expense	15,375	
Cash		50,651
Depreciation Expense	27,455	
Accumulated Depreciation		27,455

d. They are able to expense the payments rather than have the debt on their balance sheet. Additionally, it is tax deductible.

VII. Liquidity and Solvency Ratio Comparisons

	Operating	Capital
Current Ratio	1.658	1.159
Debt to Equity	0.725	1.333
LT Debt to Assets	0.000	0.436